

1999 Country Reports on Economic Policy and Trade Practices
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HONDURAS

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1997	1998	1999	1/
<i>Income, Production and Employment:</i>				
Nominal GDP (US\$) 2/	4,386	5,135.0	4,825.0	
Real GDP Growth (pct)	4.5	3.0	-3.0	
GDP by Sector:				
Agriculture	1,667.0	1,555.1	1,430.7	
Manufacturing	935.0	989.0	1,018.7	
Services	459.0	475.0	480.7	
Government	298.0	318.0	324.4	
Per Capita GDP (US\$) 3/	808	880	791	
Labor Force (000s)	1,955.0	2,040.8	2,299.0	
Unemployment Rate (pct) 4/	6.3	6.3	12.0	
<i>Money and Prices (annual percentage growth):</i>				
Money Supply (M2)	39.2	18.4	N/A	
Consumer Price Inflation	12.8	15.7	11.6	
Exchange Rate (LP/US\$ annual average)				
Official	13.14	13.54	14.56	
Parallel	13.05	13.41	14.42	
<i>Balance of Payments and Trade:</i>				
Total Exports FOB	1,445.7	1,575.0	1,220.7	
Exports to U.S.	613.6	590.7	N/A	
Total Imports CIF	2,148.6	2,499.6	2,828.9	
Imports from U.S.	1,033.0	1,165.8	N/A	
Trade Balance	-702.9	-924.6	-1,608.2	
Trade Balance with U.S.	-419.4	-575.1	N/A	
Current Account Deficit/GDP (pct)	3.3	0.3	9.4	
External Public Debt	3,454.5	3,481.8	4,383.0	
Debt Service Payments/GDP (pct)	16.6	17.3	N/A	
Fiscal Deficit/GDP (pct)	2.6	1.5	N/A	
Gold and Foreign Exchange Reserves	606	670	N/A	
Aid from U.S.	36.1	36.0	555.7	5/

Aid from Other Countries

116

N/A

243.8

1/ 1999 figures are estimates based on data available in November.

2/ GDP at factor cost.

3/ Percentage changes calculated in local currency.

4/ Merchandise trade.

5/ Includes USAID, Department of Defense, and other agencies' disaster relief and reconstruction assistance in response to Hurricane Mitch.

1. General Policy Framework

Honduras, already one of the poorest countries in the hemisphere, with low per capita income and relatively low health and education indicators, was struck a devastating blow by Hurricane Mitch. The late October 1998 disaster inundated the entire country, resulting in massive flooding and landslides that killed over 5,000 people, left tens of thousands homeless, caused over US\$ 3 billion in destruction, seriously damaged the road network, virtually wiped out the important banana crop (second largest export), and plunged the country into recession. Heavy rain during the 1999 rainy season exacerbated the damage.

Massive international assistance – led by the U.S. at over US\$ 550 million in FY 99 – provided emergency relief and is helping Honduras rebuild. Many of the homeless have already received new houses in an effort led by churches and NGO's. Epidemics have been averted, basic services restored, and temporary repairs made. The overall pace of reconstruction has been slow due to the Honduran government's lack of planning and executive capacity, the slow arrival of international aid, and the need to ensure that assistance is not misused.

Honduras has received significant debt relief in the aftermath of Hurricane Mitch, including the suspension of bilateral debt service payments and bilateral debt reduction. Honduras will likely qualify for multilateral debt reduction as well through the Highly Indebted Poor Countries (HIPC) Initiative.

Honduras continues to maintain macroeconomic stability. After an inflationary spike at the end of 1998, inflation is expected to fall to less than 12 percent for 1999. The currency (lempira) has only moderately devaluated. A widened balance of payments deficit, worsened by the Mitch-induced recession with decreased exports (from crop damage and low world prices in coffee and bananas) and increased imports (for reconstruction), is being covered by international aid, reinsurance payments, and increased family remittances. International reserves have risen.

Since 1990, succeeding governments have embarked on economic reform programs, dismantling price controls, lowering import tariffs, removing non tariff barriers to trade, adopting a free market exchange rate regime, removing interest rate controls, and passing legislation favorable to foreign investment. Honduras has committed to the International Monetary Fund to privatize management of the airports, the telephone system, and electricity distribution. Congress passed laws in late 1998 to encourage foreign investment in tourism, mining, and agriculture. The biggest success story of all has been the growth of the maquila industry (with significant U.S. investment), from virtually zero in 1989 to over 200 plants in 1999 generating over US\$ 300 million in foreign exchange and employing 110,000 workers. Nonetheless, the growth in foreign investment is hampered by a politicized judiciary subject to influence, insecure property titles, non-transparent bidding procedures, and cumbersome bureaucratic procedures.

Honduras became a founding member of the World Trade Organization (WTO) in 1995 and participates in international trade negotiations, including those related to the establishment of the Free Trade Area of the Americas. A Bilateral Investment Treaty (BIT) was signed in 1995 and ratified by the Honduran Congress, with ratification pending before the U.S. Senate. A bilateral Intellectual Property Rights Agreement was negotiated in March 1999. The Honduran Congress passed legislation in December 1999 to comply with the WTO's TRIPS agreement.

2. Exchange Rate Policy

The central bank uses an auction system to regulate the allocation of foreign exchange. Dollar purchases, in which foreigners may participate, are conducted at 5 to 7 percent above or below the base price established every 5 days. During recent auctions, the central bank has been adjudicating an average of US\$ 8 million daily. Foreign exchange demand in 1998 was 96.1 percent covered.

The Foreign Exchange Repatriation Law passed in September 1990 requires all Honduran exporters, except those operating in free-trade zones and export processing zones, to repatriate 100 percent of their export earnings through the commercial banking system. Until recently, commercial banks were allowed to use 70 percent of export earnings to meet their clients' foreign exchange needs. The other 30 percent had to be sold to the central bank at the prevailing interbank rate of exchange. Presently, commercial banks are required to sell 100 percent of these repatriated earnings to the central bank, which in turn auctions up to 60 percent in the open market.

3. Structural Policies

Trade Policy: In an effort to increase trade and maintain competitiveness with its Central American neighbors, in recent years Honduras has cut its import duties to between zero and 19 percent for most items. Certain sensitive products, such as automobiles, are assessed at a higher rate of up to 35 percent. In 1995, Honduras and other Central American Common Market (CACM) members agreed to work toward the full implementation of a common external tariff ranging from zero to 15 percent for most products, but allowed each country to determine the timing of the changes. In 1997, tariff rates were reduced to one percent on capital goods, medicines and agricultural inputs, and on raw materials and inputs produced outside of Central America. Honduras also intends to reduce its extra-regional tariffs for intermediate and finished goods over the next several years to between 10 and 17 percent.

Honduras has sought to expand trade by negotiating, together with Guatemala and El Salvador, free trade agreements with other countries. Agreements with Mexico and the Dominican Republic are mostly complete but are still held up on the status of a few sensitive products. The Central Americans are negotiating free trade agreements with Panama and Chile and are studying proposals for agreements with the Andean Community and Taiwan.

Pricing Policy: The only items under price control are coffee and medicines. The Government of Honduras maintains an informal control over prices of certain staple products such as milk, sugar, and cement by maintaining unwritten agreements with producers to limit and justify increases.

Tax Policies: President Flores' April 1999 Economic Plan decreased the corporate tax rate from 40 percent to 30 percent in 1998 and to 25 percent in 1999. The sales tax was increased from 7 percent to 12 percent in June 1998, which helped maintain government revenue in the aftermath of Hurricane Mitch despite a sharp drop in economic activity. Sales taxes were increased to 15 percent on liquor and tobacco products and are even higher on new car purchases. Export taxes on bananas are being reduced in stages from 50 cents to four cents a box by the year 2000. Export taxes on seafood, sugar and live cattle were eliminated in 1998.

4. Debt Management Policies

Debt service on Honduras' approximately US\$ 4 billion public external debt is a major constraint on growth and represented about 35 percent of the government budget in 1998. In the aftermath of Hurricane Mitch, with the consequent drop in revenue and increase in government expenditures, the need for debt relief became even more imperative. Despite Paris Club Debt Rescheduling Agreements in July 1995 and March 1996, and over US\$ 500 million in bilateral debt forgiveness (including US\$ 430 million by the U.S. in 1991), Honduras had been unable to comply with the goals of the Enhanced Structural Adjustment Facility (ESAF) negotiated with the IMF in 1992. Honduras signed a new ESAF in 1999, pledging to maintain responsible monetary policies, strengthen oversight of the financial sector, overhaul the national pension system, and accelerate the privatization of international airport management, the telephone company, and the electric company's distribution system.

Honduras received significant bilateral debt relief. In 2000, it should receive even more relief on multilateral debt service in the years to come through the Highly Indebted Poor Countries (HIPC) Initiative. Shortly after Mitch, the Paris Club suspended bilateral debt service payments until 2002. Honduras subsequently signed an agreement with the Paris Club to reduce the overall bilateral debt burden by two thirds (Naples terms), saving the country some US\$ 430 million over the next three years. The U.S. and Honduras signed a bilateral debt reduction agreement in August 1999, which should save Honduras about US\$ 65 million. Concerning the multilateral debt, which encompasses the bulk of the country's total public foreign debt, Honduras will qualify for significant debt relief under the enhanced HIPC framework established by the international donor community in Cologne in June 1999. Receipt of this relief is conditioned on the formulation of an effective poverty reduction strategy and fulfillment of the conditions of the 1999 IMF ESAF.

5. Aid

As a result of the devastation caused by Hurricane Mitch, Honduras has been receiving an unprecedented increase in foreign assistance. At the May 1999 Stockholm consultative meeting, donors pledged US\$ 2.7 billion. As of October 1999, the Honduran government reported receiving or negotiating US\$ 603.8 million in grants and US\$ 885 million in loans, primarily from the Inter-American Development Bank and the World Bank.

The U.S. has provided the single largest amount of aid to Honduras. According to Embassy calculations, the U.S. has spent or obligated US\$ 555 million in FY 99, US\$ 55 million of which was spent on immediate emergency relief and the rest in reconstruction assistance. U.S. government agencies involved in assistance to Honduras include USAID (overall coordinator), DOD, USDA, USDOC, DOT, USGS, HUD, OPIC, and Ex-Im Bank. Other countries have provided significant aid as well, including Japan, Sweden, Spain, Italy, Canada, and Germany.

6. Significant Barriers to U.S. Exporters

Import Policy: While reforms have gone far to open up Honduras to U.S. exports and investment, some protectionist policies remain. Import restrictions are imposed on firearms and ammunitions, toxic chemicals, pornographic material and narcotics. Other import restrictions are applied to chicken meat and cosmetics. Import restrictions are mainly based on phyto-sanitary, public health, public morale, and national security grounds.

Services Barriers: In certain services industries (e.g., local transportation, insurance, radio and TV stations, and distributorships), majority control must be in the hands of Honduran nationals. Special government authorization must be obtained to invest in the tourism, hotel and banking service sectors. Foreigners may not hold a seat in Honduras' two stock exchanges or provide direct brokerage services in these exchanges. Honduran professional bodies heavily regulate the licensing of foreigners to practice law, medicine, engineering, accounting, and other professions.

Labeling and Registration of Processed Foods: Honduran law requires that all processed food products be labeled in Spanish and registered with the Ministry of Public Health. The law is usually not enforced for U.S. products in recognition of U.S. health inspection procedures.

Investment Barriers: The 1992 Investment Law removed foreign ownership restrictions in most sectors. Companies that wish to take advantage of the Agrarian Reform Law, or engage in commercial fishing, forestry, or local transportation, however, must be majority owned by Hondurans.

In addition, special government authorization is required for foreign investment in the following sectors: forestry, telecommunications, basic health, air transport, fishing and aquaculture, mining, insurance and financial services, private education, and agricultural and agro-industrial activities exceeding land tenancy limits established by law.

Foreigners are barred from ownership of small businesses with equity less than 150,000 lempiras (about US\$ 11,000). Foreign ownership of land within 40 km of the coastlines and national boundaries is constitutionally prohibited, though tourism investment laws allow for certain exceptions. A proposed constitutional amendment to modify the prohibition was dropped due to opposition by minority groups living along the Caribbean Coast. In all investments, at least 90 percent of a company's labor force must be Honduran, and at least 80 percent of the payroll must be paid to Hondurans. Inadequate land titling procedures have led to numerous investment disputes involving U.S.-citizen landowners. The U.S. government has worked extensively to assist these citizens, most of whose case are being litigated in Honduran courts.

On July 1, 1995 Honduras and the U.S. signed the Bilateral Investment Treaty (BIT) at the Hemispheric Trade Ministerial in Denver, Colorado. This treaty has been ratified by the Honduran Congress; ratification by the U.S. senate is still pending.

Government Procurement Practices: Foreign firms are given national treatment for public bids, although in practice, U.S. firms complain about the mismanagement and lack of transparency of government bid processes. To participate in public tenders, foreign firms are required to act through a local agent. Local agency firms must be at least 51 percent Honduran-owned, unless the procurement is classified as a national emergency.

Customs Procedures: Customs administrative procedures are burdensome. There are extensive documentary requirements and other red tape involving the payment of numerous import duties, customs surcharges, selective consumption taxes, and warehouse levies. Honduras agreed in November 1999 to implement eight Free Trade Area of the Americas customs related business facilitation measures. Honduras is also committed to implementing the majority of provisions of the World Trade Organization's Custom Valuation Agreement by January 2000.

7. Export Subsidies Policies

Almost all export subsidies have been eliminated. Under the Temporary Import Law (RIT), exporters are allowed to introduce raw materials, parts, and capital equipment into Honduras exempt from surcharges and customs duties if the product is to be exported outside Central America. Export Processing Zones (ZIPS) are exempt from paying import duties and other charges on goods and capital equipment. In addition, the production and sale of goods within the ZIPS are exempt from state and municipal taxes. Firms operating in ZIPS are exempt from income taxes for twenty years, and municipal taxes for ten years. Foreigners exporting to Honduras are not required by law to sell through an agent or distributor, except when selling to the government.

8. Protection of U.S. Intellectual Property

In December 1999, the Honduran government passed reforms to its Intellectual Property Rights (IPR) laws to comply with the World Trade Organization's Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement's January 1, 2000 deadline. The U.S. and Honduras initialed a Bilateral IPR Agreement in March 1999. Signing of this agreement is still pending.

Despite the reforms, enforcement of IPR laws remains problematic due to insufficient resources. Although some progress have been made, there is still widespread piracy of many forms of copyrighted works, including books, sound and video recordings, compact discs, computer software and television programs. The illegitimate registration of well-known trademarks is still a problem as well.

9. Worker Rights

a. The Right of Association: Union officials remain critical of what they perceive as inadequate enforcement of worker rights by the Ministry of Labor (MOL), particularly the right to form a union. Nonetheless, in November 1995, the MOL signed a memorandum of understanding with the U.S. Trade Representative's Office to implement 11 recommendations for enforcement of the Honduran labor code and the resolution of disputes. The MOL has made positive changes implementing several of these recommendations, particularly as they relate to inspection and monitoring of maquilas (primarily, garment assembly plants). Through cooperation within the Tripartite Commission (unions, MOL, maquila association), the number of unannounced and repeat visits to maquila plants by inspectors from the MOL has increased, improving the MOL's effectiveness in enforcing worker rights and child labor laws.

b. The Right to Organize and Bargain Collectively: The law protects worker rights to organize and to bargain collectively; collective bargaining agreements are the norm for companies in which workers are organized. Three large peasant organizations are affiliated directly with the labor movement. Only about fourteen percent of the work force is unionized, therefore, the economic and political influence of organized labor has diminished in recent years. Although the labor code prohibits retribution by employers for trade union activity, it is a common occurrence. Employers actually dismiss relatively few workers for union activity once a union is recognized; such cases, however, serve to discourage workers elsewhere from attempting to organize. Workers in both unionized and non-unionized companies are under the protection of the labor code, which gives them the right to seek redress from the Ministry of Labor. Over the past year, the Ministry of Labor took action in several cases, pressuring employers to observe the code. Labor or civil courts can require employers to rehire employees fired for union activity, but such rulings are uncommon. Labor leaders criticize the Ministry for not enforcing the labor code, for taking too long to make decisions, and for being timid and indifferent to workers' needs. The Ministry has increased inspections and the training of its inspectors; it needs to do more, however, to improve observance of international labor standards.

c. Prohibition of Forced or Compulsory Labor: The constitution and the law prohibit forced or compulsory labor. Over the past year there were no official reports of such practices in the area of child labor.

d. Minimum Age for Employment of Children: According to government and human rights groups, an estimated 350,000 children work illegally. The constitution and the labor code prohibit the employment of minors under the age of sixteen, except that a child who is fifteen years of age is allowed to work with the permission of his parents and the Ministry of Labor. The Children's Code prohibits a child of fourteen years of age or less from working, even with parental permission, and establishes prison sentences of three to five years for individuals who allow children to work illegally. An employer who legally hires a fifteen-year-old must certify that the child has finished or is finishing his compulsory schooling. The Ministry of Labor grants a number of work permits to fifteen-year-olds each year. It is common, however, for younger children to obtain these documents or to purchase forged permits. The Ministry of Labor cannot effectively enforce child labor laws, except in the maquila sector, and violations of the labor code occur frequently in rural areas and in small companies. Many children work on small family farms, as street vendors, or in small workshops to supplement the family income. In September 1998, the government created the National Commission for the Gradual and Progressive Eradication of Child Labor.

e. Acceptable Conditions of Work: In the aftermath of the disastrous Hurricane Mitch, which struck Honduras in late October 1998, labor leaders agreed to forego the usual January (1999) pay increase in return for business leaders' pledge to control price increases for basic goods and services. When labor and business reached an impasse on wage negotiations in June 1999, the Catholic Church arbitrated a 25 percent increase in the minimum wage, which was decreed by the government in July. It was also agreed that as of January 1, 2000, an increase of 8 percent will be effective for all workers and that the base for both increases will be the minimum wage effective before the salary increase in July. There will not be another raise in the minimum wage throughout 2000, as long as inflation (according to central bank statistics) does not exceed 12 percent during the first six months of the year, which it appears unlikely to do.

Daily pay rates vary by geographic zone and the sector of the economy; urban workers earn slightly more than workers in the countryside. The lowest minimum wage occurs in the non-export agricultural sector, where it ranges from US\$ 2.27 to US\$ 2.89 (33.00 to 42.00 lempiras) per day, depending on whether the employer has more than 15 employees. The highest minimum wage is US\$ 3.79 (55.00 lempiras) per day in the export sector, though most workers typically earn more. All workers are entitled to an additional month's salary in June and December of each year. The constitution and the labor code stipulate that all workers must be paid a minimum wage, but the Ministry of labor lacks the personnel and other resources for effective enforcement. The minimum wage is insufficient to provide a standard of living above the poverty line for a worker and his family.

f. Rights in Sectors with U.S. Investment: The worker rights enumerated above are respected more fully in sectors with sizable U.S. investment than in sectors of the economy lacking substantive U.S. participation. For example, in a number of U.S. – owned maquila plants, workers have shown little enthusiasm for unionizing, since they consider their treatment, salary, and working conditions to be as good as, or better than, those in unionized plants. In establishing new investments in Honduras, U.S. businesses in recent years consciously have constructed their plants to meet more stringent U.S. government laws and regulations.

**Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position
Abroad on an Historical Cost Basis -- 1998**

(Millions of U.S. Dollars)

Category	Amount
Petroleum	(1)
Total Manufacturing	190
Food & Kindred Products	184
Chemicals & Allied Products	2
Primary & Fabricated Metals	(2)
Industrial Machinery and Equipment	0
Electric & Electronic Equipment	0
Transportation Equipment	0
Other Manufacturing	3
Wholesale Trade	2
Banking	5
Finance/Insurance/Real Estate	29
Services	0
Other Industries	(1)
TOTAL ALL INDUSTRIES	186

(1) Suppressed to avoid disclosing data of individual companies.

(2) Less than \$500,000 (+/-).

Source: U.S. Department of Commerce, Bureau of Economic Analysis.